Supreme Court, U.S.
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No.

In the Supreme Court of the United States

NIPPON KAIJI KYOKAI CORPORATION,
Petitioner,

v.

OTTO CANDIES, L.L.C.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Under the general maritime law promulgated and administered by the federal courts, does a certificate of class constitute the classification society's guarantee of condition, seaworthiness, or fitness for a specific purpose, or a guarantee that a vessel complies with the requirements established under a sales contract?

2. Under the general maritime law, is a classification society liable for damages to a third party when an exculpatory clause in its conditions of service excludes liability to third parties?

STATEMENT REGARDING PARTIES AND CORPORATE DISCLOSURE STATEMENT

All parties to the proceeding are listed in the caption of the case.

Petitioner has no parent corporation and no publicly-held company owns 10% or more of petitioner's stock.

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PETITION FOR WRIT OF CERTIORARI

Petitioner Nippon Kaiji Kyokai Corporation (NKK) respectfully requests this Court to grant its petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The opinion of the court of appeals is reported at 346 F.3d 530, 2003 AMC 2409 (5th Cir. 2003) and appears in the appendix of this petition ("Pet. App.") at 1a–15a. The court of appeals' unpublished order denying the petition for rehearing appears at Pet. App. A.

The district court's unpublished opinion on final judgment is available electronically at 2002 WL 1798767 (E.D. La. 2002), and appears at Pet. App. 16a–23a. The district court's unpublished order denying summary judgment is available electronically at 2002 U.S. Dist. LEXIS 5060, 2002 WL 398770 (E.D. La. 2002), and appears at Pet. App. 26a.

JURISDICTION

The court of appeals entered judgment on September 17, 2003, and denied a timely petition for rehearing on October 28, 2003. This Court has jurisdiction under 28 U.S.C. § 1254(1).

RELEVANT STATUTORY PROVISIONS

There are no statutes directly involved in this case.

STATEMENT OF THE CASE

Petitioner Nippon Kaiji Kyokai Corporation (NKK) is the Japanese classification society. It is a not-for-profit foundation organized under Japanese law as a "zaidan hojin," an entity whose essential features are the promotion of some public interest.[1] The world's classification societies "...develop and publish Rules concerning (a) the structural strength of and the watertight integrity of all essential parts of a vessel's hull and its appendages and (b) the safety and reliability of the propulsion and steering systems and those other features and auxiliary systems built into the vessel in order to establish and maintain basic conditions on board. They then inspect vessels periodically to determine whether they currently comply with these published Rules..." This is the standard definition of ship classifications as approved by the International Association of Classification Socities; *cf.* NKK Conditions of Service, ¶ 1.2 [Plaintiff Exhibit 46]. Many of the Rules are based on internationally agreed standards, often codified in regulations and conventions relating to ship safety and the prevention of marine pollution (such as the International Convention for the Safety of Life at Sea, 1974, 32 U.S.T. 47, T.I.A.S. No. 9700, and the International Convention for Prevention of Pollution from Ships, 1973, 17 I.L.M. 546, which were recently before this

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[1] In this instance, the relevant public interest is the safeguarding of life and property at sea. This is recognized as the primary purpose of all classification societies, rather than, for example, the protection of the private economic interests of those involved in shipping. *See, e.g.*, *See also, e.g.*, *Marc Rich & Co. AG v. Bishop Rock Marine Co.* ("*The Nicholas H*"), [1996] A.C. 211, 241 (describing NKK as "an independent and non-profit-making entity, created and operating for the sole purpose of promoting the collective welfare, namely the safety of lives and ships at sea").

Court in *United States v. Locke*, 529 U.S. 89 (2000)). Although the Rules address some of the factors that would be relevant in determining whether a vessel is seaworthy, the Rules themselves do not address seaworthiness. That is a very different concept from a vessel's being "in class" (which means simply that it is in compliance with the Rules).[2] Nor do they address whether a vessel would be suited for a particular purpose.

This limited role of classification societies means that their work contrasts sharply with the work of other types of surveyors. For example, the prospective purchaser of a vessel will typically obtain a "condition survey" or pre-purchase inspection that will specifically address both the seaworthiness of the vessel and its suitability for the particular purpose for which the purchaser intends to use it beyond any representation set forth in the Conditions of Service.

The distinction between classification societies and other types of surveyors is well-summarized in one of the field's standard references:

> Numerous decisions [in France, the United Kingdom, and the United States] highlight the special features of classification societies. They are not like

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[2] *Continental Insurance Co. v. Daewoo Shipbuilding & Heavy Machinery, Ltd.*, 707 F. Supp. 123 (S.D.N.Y. 1988), *aff'd mem.*, 888 F.2d 125 (2d Cir. 1989), provides a good illustration of this distinction. Cargo was damaged because a manhole cover had not been properly sealed. The cover's gasket was missing and the sealing nuts were loose. These defects would have made the vessel unseaworthy. But the classification society was not negligent. Nothing was wrong with the design and construction of the manhole cover, and that was all that the society had been required to inspect. See 707 F. Supp. at 123-24.

> other purveyors of services in the maritime sector. Unlike the shipping authorities, they have no means of coercion concerning faulty vessels: they can merely observe and report, and their report on the condition of the ship is no more than an expression of its conformity to the classification rules they themselves have issued. This represents a fundamental difference between the classification society surveyor and other maritime surveyors. The report provides no sort of 'blessing' on the seaworthiness of the ship, nor on its general level of safety.

Jonathan Lux (ed.), CLASSIFICATION SOCIETIES 25 (1993).

This case involves petitioner's classification of the *M/V Speeder*, a high speed, aluminum-hull passenger vessel. Austal Pty, Ltd., an Australian company, built the vessel and delivered it to Diamond Ferry Company (Diamond), a Japanese company, in April of 1995.[3]

Speeder was registered in Japan, built to NKK Class Rules as a "coastal (Japanese Government) passenger vessel," and operated as a passenger ferry in the inland waters of Japan from 1995 to 1996, when she was taken out of service. At Diamond's request, *Speeder* was withdrawn from class on January 31, 1996, and was not required to undergo NKK class surveys or inspections. In 1998, Diamond put *Speeder* up for sale.

In October 1999, respondent Otto Candies, L.L.C. was interested in acquiring a vessel for use in offshore petroleum operations in the Gulf of Mexico, and through a broker

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[3] Neither Austal Pty, Ltd. nor Diamond are parties to the litigation.

initiated negotiations for the purchase of *Speeder* from Diamond. In November 1999, Otto Candies, Jr., respondent's chairman and CEO, conducted his own cursory inspection of *Speeder* in Japan and observed a short sea trial arranged by Diamond. He did not employ a condition surveyor. The inspection and demonstration of the vessel's operating capabilities resulted in respondent's agreement to purchase the ship from Diamond. Petitioner took no part in the inspection, the sea trial, or the negotiations for purchase. A Memorandum of Agreement (MOA) executed on December 22, 1999, memorialized the terms of the sale. Paragraph 5, titled "DELIVERY CONDITION," provided:

> [Diamond] shall deliver to [respondent] the Vessel substantially in the same condition as when the Vessel was inspected by [respondent] . . . . In addition, the vessel shall be delivered with Japanese NKK Coastal Class restored and current. The vessel's Class certificate should be free from outstanding recommendations . . . .

[Plaintiff Exhibit 1]

The Japanese Coastal Services Certificate permitted *Speeder* to operate in Japanese waters, not more than twenty miles offshore, on specific routes or lanes. The MOA contained no requirement that *Speeder* comply with the Rules of the American Bureau of Shipping (ABS), the U.S. classification society, nor did it provide for a change in the vessel's classification status from Coastal Passenger Vessel in Japanese Waters to International Operations in the Gulf of Mexico. Respondent had the option (which it failed to exercise) of having *Speeder* surveyed by an ABS representative prior to delivery.

At Diamond's request, petitioner conducted a class re-entry survey December 7–24, 1999. In performing this work, petitioner's sole contractual relationship was with Diamond, as the owner of the *Speeder*, for survey and classification of the vessel pursuant to NKK Rules. A provisional certificate of classification issued to Diamond on December 24, 1999 (following a survey "for classification," not a condition survey) noted:

> This is to certify that the above ship having been surveyed for classification on 24 December 1999 in accordance with the Society's Rules and Regulations and reported by the surveyors to be fit for classification, has been entered provisionally in the classification register of NKK.

[Plaintiff Exhibit 2, 48] On January 5, 2000, on the basis of a review of the records filed in its head office, petitioner issued a Class Maintenance Certificate to Diamond confirming *Speeder*'s class as a Coastal Passenger Vessel with no outstanding recommendations.

The information provided for class re-entry satisfied the MOA's requirements. On January 10, 2000, Diamond and respondent executed the protocol required by the MOA, stating that all conditions of the MOA had been satisfied and that the sale was complete.

Following the purchase of *Speeder* and its removal from Japan to the United States by ship as deck cargo, respondent elected to change the classification from NKK to ABS. The ABS surveyor discovered a number of deficiencies that

needed to be repaired before ABS would classify the vessel.[4] These repairs were made at a cost of over $300,000. Ultimately, ABS issued a classification certificate to *Speeder* in Mobile, Alabama, and the name of the vessel was changed to *Seb'an*. The registry was changed from Japanese and the ABS classification status designated A-1-HSC, i.e., restrictive service, high speed craft AMS, permitting operation on international waters up to two hundred miles offshore.

On January 26, 2001, respondent filed the present action in the United States District Court for the Eastern District of Louisiana, asserting diversity jurisdiction under 28 U.S.C. § 1332. Respondent alleged that petitioner had negligently conducted the class re-entry survey of the *Speeder* in Japan, and claimed damages under a theory of negligent misrepresentation. The district court denied petitioner's motion for summary judgment on March 13, 2002. *See* Pet. App. 24a. After a bench trial, it ruled for respondent on August 5, 2002. *See* Pet. App. 16a.

On appeal, the United States Court of Appeals for the Fifth Circuit affirmed. Although the panel recognized several ways in which the "[i]mposition of undue liability on classification societies could be harmful," Pet. App. 8a, 346 F.3d at 535, it nevertheless held "that general maritime law cautiously recognizes the tort of negligent misrepresentation as applied to classification societies," Pet. App. 2a, 346 F.3d at 532. Despite the court's repetition of the well-recognized maritime law principle that a "certificate or survey in no way guarantees a vessel's seaworthiness . . . but extends only as far as the nature of the survey performed," Pet. App. 13a,

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[4] Two surveys were conducted by ABS: The first to transfer class from NKK to ABS; the second to change the class status from Japanese Coastal Class to International Class.

346 F.3d at 538, the court ruled for the respondent on the theory that the class certificate made petitioner responsible for Diamond's failure to deliver the *Speeder* in the condition required by the MOA.

REASONS FOR GRANTING THE PETITION

The court of appeals failed to recognize the limited role of a classification society and—in conflict with courts in this country and abroad—treated a certificate of class as something it was never intended to be. In imposing unprecedented liability on a classification society, the court departed from widely-recognized principles of maritime law.

The court below also departed from widely-recognized principles of maritime law in failing to give effect to an exculpatory clause in petitioner's conditions of service.

The court of appeals' decision raises an important issue that this Court should resolve in order to prevent serious problems for the maritime industry.

I. By treating a certificate of class as the classification society's guarantee of condition, seaworthiness, or fitness for a specific purpose, or as a guarantee that a vessel complies with the requirements established under a sales contract, the Fifth Circuit has departed from widely-recognized principles of maritime law applied in this country and abroad

In its decision, the Fifth Circuit paid lip service to limitations on claims against classification societies, as well as the general maritime law principle that the activity of a classification society should not derogate from a shipowner's nondelegable duty to maintain a seaworthy vessel. But the

court of appeals departed from the well-established principles of maritime law in construing the class certificate issued to *Speeder* as a guarantee of condition, seaworthiness, or fitness for a specific purpose, and in believing that it could be considered a guarantee applicable to the MOA such that it was reasonable for respondent to rely upon it. This has the effect of putting a classification society in a position akin to an insurer of the condition of the vessel and a guarantor of the MOA, which is inconsistent with the status of classification societies in principle and in authority. A survey by a classification society does not substitute for the shipowner's obligations to ensure the proper condition of the vessel. The decision below is at odds with that principle because its effect is to transfer the general maritime law and MOA obligations regarding the condition of the vessel from Diamond to NKK (which was not party to the MOA), contrary to the limited role of a classification society. Respondent's complaint in essence concerned the unseaworthiness or defective condition of the vessel, both of which are the absolute and nondelegable responsibility of the shipowner (Diamond). These obligations should not be imposed on or transferred to a classification society.

The court of appeals has therefore seriously misinterpreted the function and purpose of a classification society, imposing also on petitioner the responsibility for conducting a condition survey rather than a classification survey. The NKK Rules and Conditions of Service call for nothing more than a determination that *Speeder* was in compliance with the NKK Rules for its class as a coastal ferry in Japanese waters, operating within sight of land.

In *Great American Insurance Co. v. Bureau Veritas*, 338 F. Supp. 999, 1010 (S.D.N.Y. 1972), *aff'd*, 478 F.2d 235

(2d Cir. 1973), the court concisely summarized the general maritime law rule:

> In agreeing to classify [the vessel], Bureau Veritas [a classification society] undertook no more than to make a statement that the condition of the ship either was or was not in conformity with certain published standards established by the society.

The court also noted the "long-standing" maritime law rule that a shipowner "has a non-delegable duty to maintain a seaworthy vessel." 338 F. Supp. at 1012.

In *Sundance Cruises Corp. v. American Bureau of Shipping*, 7 F.3d 1077, 1084 (2d Cir. 1993), *cert. denied*, 511 U.S. 1618 (1994), the Second Circuit reaffirmed the respective functions of a classification society and a shipowner:

> [T]he shipowner, not [the classification society], is ultimately responsible for and in control of the activities aboard ship. . . . This ongoing responsibility for the vessel is supplemented by the maritime-law requirement that the shipowner has a nondelegable duty to furnish a seaworthy vessel. . . .[The classification society] can not be said to have taken over [the shipowner's] obligations in this regard by agreeing to inspect and issue a classification certificate to [the shipowner].

See also, e.g., Cargill Inc. v. Bureau Veritas, 902 F. Supp. 49, 52 (S.D.N.Y. 1995) (recognizing that because "a classification society is not liable to a shipowner as an insurer of the seaworthiness of a vessel," it "is also not liable as an insurer of the vessel's seaworthiness to third part[ies]").

Not only is the decision below in conflict with the relevant jurisprudence of other courts in the United States, it stands in conflict with the maritime law decisions of other major shipping nations. The leading decision on this subject internationally is, coincidentally, another case involving NKK, *Marc Rich & Co. AG v. Bishop Rock Marine Co.* ("*The Nicholas H*"), [1996] A.C. 211, in which the House of Lords, the highest court in Great Britain, expressly recognizing the nature of the position and role of classification societies, held that it would be unfair, unjust, and unreasonable to hold a society liable to a third-party cargo owner.

Petitioner's class certificate made no statement with respect to the *Speeder* except that she was in compliance with NKK Rules and Regulations. Under these circumstances, petitioner's responsibility to Diamond was clear and understandable, and required petitioner only to have followed its own procedures to determine whether the *Speeder* was in compliance with its Rules. It made no guarantees of condition, seaworthiness, or fitness for a specific purpose, nor did it guarantee the condition of the vessel for the purposes of the MOA.

Because petitioner's class certificate made no statement with respect to the *Speeder* except that she was in compliance with NKK Rules and Regulations, it would have been unreasonable for respondent to rely on any statement by petitioner as a guarantee of condition, seaworthiness, or fitness for a specific purpose, or a guarantee of the condition of the vessel for the purposes of the MOA. *Cf. Cargill*, *supra*, 902 F. Supp. at 53 (finding even reliance by third parties on a vessel's listing in a classification society's register as a representation of the ship's current class status to have been unreasonable).

II. By holding a classification society liable for damages to a third party when an exculpatory clause in its conditions of service excludes liability to third parties, the Fifth Circuit has departed from widely-recognized principles of maritime law applied in this country and abroad

Even if the class survey had been conducted improperly, the Conditions of Service relieved petitioner from responsibility. The function of a classification society as reflected in its contract with the shipowner and by traditional concepts of maritime law is limited to certification, for the benefit of the shipowner, that the vessel complies with the Rules and Regulations of the society.[5] The relationship between petitioner and Diamond was governed by the Conditions of Service, set out in petitioner's Rules, which, apart from explaining in clear terms the limitations of classification as referred to above, included clauses that relieve petitioner from liability for any representation or warranties of seaworthiness or conditions, and from any right or claim to any third party. The court of appeals erred in finding petitioner liable to a third party in light of the exculpatory clauses in petitioner's Conditions of Service (which are substantially the same as the conditions of service under which all classification societies operate).

During the time the ship was classified by NKK, she was subject to the NKK Rules, including the Conditions of

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[5] *See, e.g., Great American Insurance Co. v. Bureau Veritas*, 338 F. Supp. 999, 1012 (S.D.N.Y. 1972), *aff'd*, 478 F.2d 235 (2d Cir. 1973); *Steamship Mutual Underwriting Association, Ltd. v. Bureau Veritas*, 380 F. Supp. 482, 488 (E.D. La. 1973); *Sundance Cruises Corp. v. American Bureau of Shipping*, 7 F.3d 1077 (2d Cir. 1933), *cert. denied*, 511 U.S. 1618 (1994); *Gulf Tampa Drydock v. Germanischer Lloyd*, 634 F.2d 874 (5th Cir. 1981).

Service. These standard contract terms (agreed to and accepted by all parties) included an exculpatory clause relieving petitioner from liability or responsibility on third party claims. The Conditions of Service provided, inter alia, as follows:

> 2.1.1 The conditions of service . . . shall apply to the provision by the Society of services, information or advice of whatever nature relating to the classification of ships . . . and shall be deemed to be, and treated as being, incorporated into all and any contracts and/or other arrangements entered into by the Society with any party.
>
> * * *
>
> 2.1.3(4) The classification of a ship . . . and/or any document, information or advice issued or provided by the Society relating thereto shall not constitute a representation, statement or warranty of seaworthiness, structural integrity or quality or fitness for a particular purpose or service beyond any representation set forth in the Rules of the Society and shall be for the sole use of the Society and its clients or other duly authorized entities and no other party.
>
> 2.1.4 Nothing contained herein, or in any document, information or advice issued or provided in connection with or pursuant to the performance by the Society of its services, shall be deemed to relieve any designer, naval architect or engineer, builder, manufacturer, shipyard, seller, supplier, contractor or sub-contractor, repairer, or ship owner, operator or other entity from any warranty or any other contractual obligations express or implied or from any fault whatsoever, nor to create any right, claim or benefit in any third party.

* * *

> 3.1.1 Neither the Society nor any of its officers, directors, employees, agents or sub-contractors shall be liable for any loss, damage or expense of whatever nature sustained by any person, in tort or in contract or otherwise, due to any act or omission or error of whatever nature whether or not negligent howsoever caused in the provision of services, information or advice given in any way whatsoever by or on behalf of the Society. . . .

[Plaintiff Exhibit 46] The Conditions of Service, including these quoted provisions, governed the relationship between petitioner and Diamond and all of the services that NKK performed in this case were performed subject to these conditions.

Furthermore, the Class Maintenance Certificate contained the following wording on its face:

> This certificate is issued subject to the understanding that in no circumstances shall the Society be held responsible for inaccuracy in any report or certificate issued or published by the Society or its surveyors or in any entry in the Register Book or other publication of the Society or for any judgement, fault or negligence of its staff, surveyors, agents or Committee of the Society.

[Plaintiff Exhibit 2]

The Court in *Gulf Tampa Drydock v. Germanisher Lloyd*, 634 F.2d 874 (5th Cir. 1981), denied a third-party claim brought against a classification society, and remanded the case to the district court with the suggestion that it consider the

effect of exculpatory clauses in the Conditions of Engagement agreed to by the parties.

All of petitioner's representations in this case were qualified by the limitations of the NKK Conditions of Service. Diamond was accordingly in much the same position as a person who buys merchandise "as is," *see, e.g.,* Uniform Commercial Code § 2-316(3)(a), or the purchaser of real property under a quit-claim deed, *see, e.g.*, Richard R. Powell, POWELL ON REAL PROPERTY § 81A.03[1][c] (rev.ed. 2003) (distinguishing a quit-claim deed, in which no covenants are made, from a warranty deed). Neither benefits from any warranty. Subsequent buyers of the merchandise (who are third parties much like the respondent) cannot sue the original seller for breach of warranty if the merchandise turns out to have been defective. *See, e.g., Transport Corp. of America, Inc. v. International Business Machines Corp.*, 30 F.3d 953, 958-59 (8th Cir. 1994). And subsequent purchasers of the real property cannot sue the original grantor if there is a defect in the title. See *e.g.,* Powell, *supra,* §81A.06[5][a] (explaining that "no recovery is available" to a subsequent purchaser from a prior grantor who "made no covenants"). These common scenarios illustrate the wider principle that third-party beneficiaries of a contract must take their benefit subject to the contract's terms. In this context, respondent could not reasonably rely on any statement in a classification certificate except subject to the contract's terms—including the exculpatory clauses incorporated in the certificates.

The NKK Conditions of Service were an integral part of the NKK Rules, they define the basis upon which NKK carries out its work (as with all other classification societies), they were agreed upon by Diamond and petitioner long before the sale of the *Speeder* to respondent, and were specific in

disclaiming responsibility of petitioner for liability in the creation of any right, claim, or benefit to a third party.

Petitioner's obligation to respondent can be no greater than its obligation to Diamond, which was a party to the contract at the time of the survey, and pursuant to which petitioner neither warranted the seaworthiness or condition of the vessel, and by issuing the class certificate, represented only that the vessel met NKK's Rules and Regulations for its class as a coastal passenger ferry. Petitioner had no part in negotiations for the sale of the vessel to CANDIES and was, for all intents and purposes a stranger to the transaction.

III. The decision below raises an important issue that this Court should resolve

The court of appeals not only erred in reaching a decision in conflict with the holdings of other courts in this country and abroad, it created serious problems for the maritime industry that this Court should correct.

A. The decision below creates serious problems for the maritime industry

The most obvious danger in finding liability on the part of a classification society for a vessel class survey is the shifting of responsibility for seaworthiness and conditions from the shipowner to the classification society. This would make the society an insurer, a position that the contracting parties never intended and that maritime law and the international trade system do not impose.

In *Great American Insurance Co. v. Bureau Veritas*, 478 F.2d 235, 236 (2d Cir. 1973), the Second Circuit emphasized the policy of not permitting surveys and classification to

operate as a defense to the duty of providing a seaworthy ship, and this preserved "the ancient and absolute responsibility of an owner for the condition of the ship." The language is strong and to the point, suggesting in no uncertain terms that the accountability should lie with vessel owners. To permit recovery against a classification society would effectively relieve the owner of its obligations. *See also, e.g., Sundance Cruises, supra*, 7 F.3d at 1084 ("[T]he shipowner, not [the classification society], is ultimately responsible for and in control of the activities aboard ship.").

The well-known *Marine Sulphur Queen* litigation similarly stressed the importance of holding the shipowner responsible for the seaworthiness of the vessel, notwithstanding any possible failures on the part of the classification society. *See In re Marine Sulphur Transport Corp.*, 312 F. Supp. 1081, 1101 (S.D.N.Y. 1970), *aff'd in part and rev'd in part sub nom. In re Marine Sulphur Queen*, 460 F.2d 89 (2d Cir. 1972), *cert. denied sub nom. United States Fire Insurance Co. v. Marine Sulphur Transport Corp.*, 409 U.S. 982 (1972).

Even the court below understood that "[t]he shipowner, not the classification society, must remain ultimately responsible for the ship's condition," Pet. App. 6a, 346 F.3d at 534, and recognized that imposing liability on classification societies "could diminish owners' sense of responsibility for vessel safety," Pet. App. 8a, 346 F.3d at 535. But by allowing respondent to recover in full from petitioner for the losses caused by Diamond's failure to delivery a seaworthy vessel in accordance with the MOA, the court of appeals allowed Diamond—the shipowner that should properly have been responsible for the damage—to avoid liability. In view of the realities of litigation, injured parties will almost inevitably pursue classification societies in preference to shipowners that were so irresponsible as to allow their vessels

to become unseaworthy—despite the fact that they would have valid claims against the shipowners, just as respondent had a perfectly good contractual claim against Diamond that it chose not to pursue.

The serious problems created by the decision below do not stop there. Once again, the court below recognized another of the very problems that it was creating: Imposing liability on classification societies will deter them "from performing work on old or damaged vessels that most need their service." Pet. App. 8a, 346 F.3d at 535. These "old or damaged vessels" most need the service of a classification society precisely because they are the ones with the greatest need of identifying safety-related deficiencies. But this very need also makes them the ones most likely to be involved in an accident at sea, and thus the ones most likely to spark litigation that could be devastating for a classification society. *See also, e.g., Marc Rich, supra*, [1996] A.C. at 241 (remarking that a finding of liability would create "a risk that classification societies might be unwilling . . . to survey the very vessels which most urgently require independent examination").

Finally, the court below noted that imposing liability on classification societies will lead to "higher fees charged to the societies' clients throughout the maritime industry." Pet. App. 8a, 346 F.3d at 535. Unfortunately, the court was undeterred by the fact that this would not be "cost-efficient." In this case, for example, petitioner charged a very modest fee[6] in accordance with a tariff based on the cost that is necessary for the effective operation of a non-profit organization. *See also, e.g., Sundance Cruises, supra*, 7

[6] Petitioner charged less than ¥460,000 for the reentry survey, which is less than $4,500 at the current exchange rate. It charged only ¥38,010 ($362) for the Class Maintenance Certificate.

F.3d at 1084 ("conclud[ing] that the small fees charged could not have been intended to cover the risk of such liability; the ship classification industry could not continue to exist under such terms"); *Great American Insurance Co. v. Bureau Veritas*, 338 F. Supp. 999, 1012 (S.D.N.Y. 1972) ("[M]aking the classification society an absolute insurer of any vessel it surveys and certifies [is] not in accord with . . . the fees charged."), *aff'd*, 478 F.2d 235 (2d Cir. 1973); *Marc Rich, supra*, *Marc Rich, supra*, [1996] A.C. at 299, (1995) 2 Lloyd's Rep. at 299 (recognizing that the imposition of disproportionate liability on classification societies would be economically undesirable and would threaten the viability of the classification industry, which constitutes an essential part of maritime operations).

The British House of Lords has recognized a number of additional ways in which the imposition of disproportionate liability on classification societies would create serious problems for the maritime industry. In *Marc Rich, supra*, Lord Steyn, who gave the leading speech, found there to be no doubt that classification societies would be unable to perform their functions as efficiently "if they become the ready alternative target of [third parties], who already have contractual claims against shipowners." [1996] A.C. at 241. Lord Steyn went on to say that there would be no logical limit if such liability were imposed, *see id.*, and recognition of such liability would enable parties to "outflank" their contractual arrangements, *see id.* at 242. This would be bad not only for classification societies, but also for shipowners (who would ultimately have to bear the cost of holding classification societies liable) and the public at large. Classification societies act in the public interest. They are created and operated for the purpose of promoting the collective welfare, the safety of lives and ships. They fulfill a role that, in their absence, would have to be fulfilled by

government. If they were to be subject to this liability, it would divert men and resources from saving life and ships at sea. *See id.*

It is ironic that the court of appeals understood the problems that its decision would create far better than it understood the role and function of the classification societies that will be so severely harmed by the decision. The court below was right to foresee that its opinion would undermine the shipowners' nondelegable duty to maintain a seaworthy vessel, deter classification societies from performing their most-needed work, and demand a reevaluation of the industry's economic system. Now this Court's intervention is needed to prevent these disastrous results from occurring.

B. The international maritime community has recognized the overwhelming significance not only of this issue but also of this particular decision

The overwhelming significance of this remarkable case is underscored by the extensive attention that it has received so far in the international press covering maritime issues. An article in the *Marine Digest and Cargo Business News*, for example, described the case in detail and commented on the extent to which a classification society's potential liability "depend[s] on what part of the country you live in." Steve Block, *No Class Act: A Bad Survey Lands a Classification Society in Hot Water*, Marine Digest & Cargo Business News, Nov. 16, 2003, at 16. An extensive discussion in *Fairplay*, anticipating that the case will be an invitation to future litigation on behalf of "buyers, charterers and other 'third parties,'" predicted that the decision below will be seen "as a hole in the dyke through which more water may flow," despite the panel's attempt to limit its holding. Ann Moore,

Candies' Bitter Pill for ClassNK, Fairplay, Nov. 27, 2003, at 12.

A news story in *Tradewinds* expressed implicit surprise at the Fifth Circuit's result, noting "that NKK was liable for the cost of repairs, even though it had issued the certificate to the sellers [i.e., Diamond], not the buyers [i.e., respondent]." Liz Shuker, *NKK Found 'Negligent' in Classification*, Tradewinds, Sept. 26, 2003, at 26. The *National Law Journal*'s short summary of the case highlighted the panel's "warn[ing] that holding maritime classification societies liable could diminish ship owners' sense of responsibility for the safety of their vessels." *Maritime Society Liable for Wrong Certification*, National Law Journal, Oct. 20, 2003, at 14.

Other coverage of the case, which illustrates the business community's strong interest in the issue, includes Sandra Speares, *A Class Society May Be Held Accountable for Misrepresenting a Vessel's Condition*, Lloyd's List, Oct. 1, 2003, at 6; *Negligence—Whether Classification Society Liable for Negligent Misrepresentation Relating to Vessel's Class*, Lloyd's Maritime Law Newsletter 626, Nov. 14, 2003, at 1-2; *Business, Banking and Contracts*, Texas Lawyer, Oct. 27, 2003, at 200; *Maritime Law*, Texas Lawyer, Sept. 29, 2003, at 200.

A case that will have such serious consequences on a significant industry and that has been a major focus of attention in this country and abroad practically demands this Court's attention.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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January 23, 2004

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Case No. 02-30842

[Filed October 28, 2003]

OTTO CANDIES LLC)
Plaintiff - Appellee,)
v.)
NIPPON KAIJI KYOKAI CORPORATION)
Defendant - Appellant)
)

Before JONES and BENAVIDES, Circuit Judges and KAZEN, District Judge.*

ON PETITION FOR REHEARING

PER CURIAM:

IT IS ORDERED that the petition for rehearing is denied.

ENTERED FOR THE COURT:

/s/
Edith H. Jones, United States Circuit Judge

* Chief District Judge of the Southern District of Texas, sitting by designation.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Case No. 02-30842

[Filed September 17, 2003]

OTTO CANDIES, L.L.C.,	)
Plaintiff-Appellee,	)
	)
versus	)
	)
NIPPON KAIJI KYOKAI CORPORATION,	)
Defendant-Appellant.	)
	)

Appeal from the United States District Court
for the Eastern District of Louisiana
01-CV-1933-M
Peter Beer, US District Judge

Before JONES and BENAVIDES, Circuit Judges, and KAZEN, District Judge.*

* Chief District Judge of the Southern District of Texas, sitting by designation.

OPINION

EDITH H. JONES, Circuit Judge:

Appellant Nippon Kaiji Kyokai Corporation ("NKK") appeals from the judgment in a negligent misrepresentation case based on statements NKK made in a classification survey of the M/V SPEEDER that was a prerequisite to the vessel's sale. We hold that general maritime law cautiously recognizes the tort of negligent misrepresentation as applied to classification societies and that on the specific facts presented in this case, NKK owed a legal duty to Otto Candies. Finding no error in the district court's judgment, we affirm.

BACKGROUND

The SPEEDER is a high speed, aluminum hulled passenger vessel built by Austal Pty Ltd. Diamond Ferry Co., Ltd. ("Diamond") took delivery of the SPEEDER in April 1995. The SPEEDER was registered in Japan and was classified by NKK as a "coastal (Japanese Government) passenger vessel." Diamond operated the SPEEDER as a coastal passenger ferry from 1995 to 1998 in Japan. In 1998, Diamond took the SPEEDER out of service, and her NKK classification lapsed. On December 22, 1999, Otto Candies entered into a Memorandum of Agreement ("MOA") with Diamond to purchase the SPEEDER. As a condition of sale, a clause in the MOA required that NKK restore and make current the SPEEDER's coastal classification free from any outstanding recommendations.

On January 5, 2000, NKK issued a Class Maintenance Certificate to Diamond that indicated the SPEEDER was certified within class as a coastal passenger ferry with no outstanding deficiencies. This condition of the MOA being

satisfied, Otto Candies paid for the SPEEDER and it was transported from Japan to Port Everglades, Florida aboard a heavy lift ship. From Port Everglades, the SPEEDER was towed to the Bender Shipyard in Mobile, Alabama. Once the SPEEDER arrived in Mobile, Otto Candies arranged for a survey by the American Bureau of Shipping ("ABS") so that the vessel's classification could be transferred from NKK to ABS.

The ABS surveyor, Demetri Stroubakis, discovered a number of significant deficiencies that required repair before ABS would classify the SPEEDER. In particular, Stroubakis noted damaged and wasted overhead spool piping sections that connect the cooling system machinery to the hull; a hull fracture in the port-aft main-engine exhaust connection to the hull; fractured hull brackets, wasted cooling piping, leaks in the port and starboard stabilizer fins; excessive movement in the starboard stabilizer shaft; leaks in the port-forward main-engine sea strainer that filters the water used to cool the engines; disconnected and missing bilge pumps; gas and water leaks in the exhaust system; a faulty circuit breaker for the starboard generator; severe damage to the port-aft main propulsion gear; exterior and interior leaks in the main reduction gear oil coolers; damage to the starboard-forward main engine; damage and deterioration in the ventilation system for the port-aft engine; corroded hose and pipe connections for the main and auxiliary engine fuel and lube oil systems that created a severe fire hazard; leaking water-jet pump shaft seals; a heavily corroded port and starboard water-jet pump-bladder accumulator-block valve; and that the engine oil was sooty, black, and contained particulate matter which suggested problems with the machinery. In response to Stroubakis's report, Otto Candies had the SPEEDER repaired at the Bender shipyard at a cost of $328,096.43. When repairs were completed, ABS issued an interim class certificate.

Otto Candies filed the instant suit against NKK to recover the costs of repairs needed for the SPEEDER to obtain a class certificate from ABS. Otto Candies's sole claim against NKK was based on the tort of negligent misrepresentation as stated in the *ALI Restatement (Second) of Torts* § 552. The district court held a two day bench trial, after which it found that NKK owed a duty to Otto Candies and that NKK was liable for negligent misrepresentation. The court awarded Otto Candies damages for the repair costs. NKK timely appealed.

STANDARD OF REVIEW

In admiralty cases we review the district court's legal conclusions *de novo*. *Lake Charles Stevedores, Inc. v. Professor Vladimir Popov MV,* 199 F.3d 220, 223 (5th Cir. 1999). We review the district court's factual findings for clear error. *Houston Exploration Co. v. Halliburton Energy Servs., Inc.,* 269 F.3d 528, 531 (5th Cir. 2001) (citing Fed. R. Civ. P. 52(a)). Findings of negligence are factual findings. *Jackson v. OMI Corp.,* 245 F.3d 525, 528 (5th Cir. 2001). "Under a clear error standard, this court will reverse 'only if, on the entire evidence, we are left with the definite and firm conviction that a mistake has been made.'" *Walker v. Cadle Co. (In re Walker),* 51 F.3d 562, 565 (5th Cir. 1995) (quoting *Allison v. Roberts (In re Allison),* 960 F.2d 481, 483 (5th Cir. 1992)).

DISCUSSION

NKK is one of the world's largest maritime classification societies. Classification societies are "organized societies which undertake to arrange inspections and advise on the hull and machinery of a vessel from its initial stages in new building and thereafter. The societies produce a certificate concerning the vessel's seaworthiness in accordance to the

trade within which it is intended to, or does, work." Damien L. O'Brien, *The Potential Liability of Classification Societies to Marine Insurers Under United States Law*, 7 U.S.F. Mar. L.J. 403, 403 (1995) (quoting Eric Sullivan, *The Marine Encyclopedia Dictionary* 78 (1980)). These certificates are widely relied upon by all sectors of the maritime industry as an indication that a vessel is reasonably fit for its intended use. Machale A. Miller, *Liability of Classification Societies from the Perspective of United States Law*, 22 Tul. Mar. L.J. 75, 77 (1997); *Hannu Honka, The Classification System and its Problems with Special Reference to the Liability of Classification Societies*, 19 Tul. Mar. L.J. 1, 3 (1994) (noting that "certificates are important not only to insurers, but also to charterers, cargo owners, buyers, and bankers, among others, who are required to know the ship's condition at a specific time.").

Citing a previous decision of this court, the parties assumed that NKK can be held liable under general federal maritime law for the tort of negligent misrepresentation. *Coastal (Bermuda) Ltd. v. E. W. Saylott & Co.*, 826 F.2d 424 (5th Cir. 1987).[1] It is true that *Coastal (Bermuda)* applied the

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[1] The parties assumed, and so do we *arguendo*, that general federal maritime law, not state law, applies to this case. This is because we normally do not address choice of law issues *sua sponte*. *Am. Int'l Trading Corp. v. Petroleos Mexicanos*, 835 F.2d 536, 540 (1987) ("It is well established that 'parties generally are bound by the theory of law they argue in the district court, absent some 'manifest injustice.'") (quoting *Shelak v. White Motor Co.*, 581 F.2d 1155, 1160 (5th Cir. 1978)). Since the district court's jurisdiction in this case is based upon the diversity of citizenship of the parties pursuant to 28 U.S.C. 1332 (2000), whether this tort arises under general maritime law or state law does not affect jurisdiction.

principles of Section 552 of the *Restatement (Second) of Torts* to a cargo purchaser's damage claim against a petroleum products surveyor, and reversed a judgment for the purchaser, but that ruling does not automatically translate to the relations between maritime classification societies like NKK and their clients or third parties. Indeed, this court earlier reversed and remanded a case to ascertain what duties a classification society may owe its shipowner clients, in contract or tort, for negligent inspection of a damaged ship. *Gulf Tampa Drydock Co. v. Germanischer Lloyd,* 634 F.2d 874 (5th Cir. 1981).

A handful of cases in other jurisdictions has explored the duty of classification societies, yielding one definitive court of appeals holding that a classification society cannot be liable in contract or tort to a shipowner for a negligent survey regarding vessel seaworthiness. *Sundance Cruises Corp. v. The American Bureau of Shipping,* 7 F.3d 1077 (2d Cir. 1993). The court noted that "a shipowner is not entitled to rely on a classification certificate as a guarantee . . . that the vessel is soundly constructed." 7 F.3d at 1084. The shipowner, not the classification society, must remain ultimately responsible for the ship's condition.

With respect to an injured third party "who relied on the classification or safety certificates," however, the Second Circuit suggested a different result might obtain.[2] In cases

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[2] A year later, the Second Circuit held an independent hold inspector liable, as a matter of contract, not tort law, to its client Cargill for defectively certifying the condition of a ship's hold for the carriage of Cargill's fertilizer. The court distinguished the purpose of the hold survey from that of a classification certificate to a shipowner, the latter being intended "merely to . . . take advantage of the insurance rates available to a classed vessel."

before and after *Sundance*, parties have sought to recover from classification societies after they suffered loss or damage allegedly attributable to defective classification certificates. One case from the Southern District of New York assumed *arguendo*, following the *Sundance* dicta, that a maritime claim for negligent representation exists against a classification society on behalf of cargo owners. *Cargill, Inc. v. Bureau Veritas,* 902 F. Supp. 49 (S.D.N.Y. 1995). In Cargill, the cargo owner lost, because there was no evidence that it actually relied on the classification certificates. In another case, a classification society was held liable for negligent misrepresentation to a ship charterer for whose benefit it furnished an incorrect Suez Canal special tonnage certificate. The certificate was used, *inter alia*, to calculate fees for passage through the Suez Canal. *Somarelf v. The American Bureau of Shipping,* 720 F. Supp. 441 (D.N.J. 1989). The theory behind this case predates, but is consistent with the court's *dicta* in *Sundance*.

The district court's adjudication of liability against NKK therefore moves this court into novel but not entirely unchartered territory. Although the verdict was appropriate in this case, we emphasize that a claim for negligent misrepresentation in connection with the work of maritime classification societies should be strictly and carefully limited. The societies' surveys and certificate system are essential to maintaining the safety of maritime commerce, yet their activities should not derogate from shipowners' and charterers' nondelegable duty to maintain seaworthy vessels.

International Ore and Fertilizer Corp. v. SGS Control Services, Inc., 38 F.3d 1279, 1285 (2d Cir. 1994), quoting *Sundance, supra,* 7 F.3d at 1084. In *Coastal (Bermuda)*, by contrast, the plaintiff was a third party to the fuel oil inspection report prepared by Saybolt for the cargo's seller, rendering tort principles applicable.

Imposition of undue liability on classification societies could be harmful in several ways. The societies could be deterred by the prospect of liability from performing work on old or damaged vessels that most need their advice. The spreading of liability could diminish owners' sense of responsibility for vessel safety even as it complicates liability determinations. Ultimately, broader imposition of liability upon classification societies would increase their risk management costs and rebound in higher fees charged to the societies' clients throughout the maritime industry. Whether such risk-spreading is cost-efficient in an industry with well-developed legal duties and insurance requirements is doubtful. The distinctions articulated in caselaw to date recognize the care with which claims against classification societies must be studied.

After noting this essential caveat, we proceed to the merits of the case. To prevail on a cause of action for negligent misrepresentation under section 552 of the *Restatement (Second) of Torts*, Otto Candies had to establish that (1) NKK, in the course of its profession, supplied false information for Otto Candies's guidance in a business transaction; (2) NKK failed to exercise reasonable care in gathering the information; (3) Otto Candies justifiably relied on the false information in a transaction that NKK intended to influence; and (4) Otto Candies thereby suffered pecuniary loss. *Coastal (Bermuda) Ltd., supra* at 428-29, (5th Cir. 1987) (citing *Grass v. Credito Mexicano, S.A.*, 797 F.2d 220 (5th Cir. 1986)).

Additionally, a plaintiff claiming negligent misrepresentation must be a "person, or a member of a 'limited group' of persons, for whose benefit and guidance the defendant either intends to supply the information or knows that the recipient intends to supply it." *Great Plains Trust Co.*

v. Morgan Stanley Dean Witter & Co., 313 F.3d 305, 318 (5th Cir. 2002) (quoting *Scottish Heritable Trust, PLC v. Peat Marwick Main & Co.*, 81 F.3d 606, 612 (5th Cir. 1996)). Thus, Otto Candies must establish that NKK provided the class certificate to Diamond and knew that Diamond intended it for Otto Candies's guidance and benefit.[3]

This is because "[t]he Restatement expressly limits liability to a select group of nonclients who the misinformer *actually knows* will receive inaccurate information . . . ." *First Nat'l Bank of Commerce v. Monco Agency Inc.*, 911 F.2d 1053, 1061 (5th Cir. 1990) (emphasis added). The fact that it was merely possible or foreseeable that a nonclient of the information supplier would rely on the information is insufficient. *Scottish Heritable Trust, PLC,* 81 F.3d at 612; *First Nat'l Bank of Commerce,* 911 F.2d at 1059-60. Furthermore, the information supplier's liability under section 552 is limited to those persons whom the engagement is intended to benefit. *First Nat'l Bank of Commerce,* 911 F.2d at 1059; *Bily v. Arthur Young & Co.*, 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P.2d 745, 769 (Cal. 1992).

Diamond engaged NKK to certify the SPEEDER pursuant to the terms of the MOA, and the court found that NKK was aware (1) that its certification of the SPEEDER was directly related to the pending sale of the SPEEDER to Otto Candies and (2) that the certification would be used to guide Otto Candies's decision to buy the SPEEDER. NKK challenges these findings as clearly erroneous. They are not.

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[3] Neither party contends that NKK directly provided the certificate to Otto Candies.

The district court admitted into evidence written correspondence from James Aitkenhead, a ship broker, to Otto Candies directly supporting the court's findings. Aitkenhead's communications reveal that NKK was aware of the pending sale of the ship; that NKK's reclassification of the SPEEDER free of recommendations was a condition of the agreement under which the SPEEDER was to be sold; and that Otto Candies's purchase of the SPEEDER would be based on NKK's classification of the ship free of recommendations.

NKK argues that the correspondence is inadmissible hearsay and that the correspondence was withdrawn after being offered and was not admitted into evidence. NKK's argument is baseless. According to NKK, the Index to Otto Candies's trial exhibits indicates the correspondence was not admitted. On the contrary, the copy of the index found in the record notes that the district court admitted the exhibits at issue into evidence during the first day of the bench trial.

Additionally, despite NKK's representations to this court, there is no indication in the record that NKK objected at trial to the documents at issue. For the first time in its reply brief, however, NKK objects, but it furnishes no legal analysis supporting its argument that the correspondence is hearsay. Thus, any argument NKK may have had is waived. *Cavallini v. State Farm Mut. Auto Ins. Co.*, 44 F.3d 256, 260 (5th Cir. 1995) (issues first raised in a reply brief will not be considered).

NKK also argues that it could not have known that its certification report would be supplied to Otto Candies because it had no direct communication with Candies. Direct communication is unnecessary. Section 552 requires instead that the information supplier actually know the parties to

whom and for whose explicit guidance the information is to be supplied.

The mere foreseeability that third parties may rely on such reports or certificates is also insufficient for purposes of section 552. *See First Nat'l Bank of Commerce,* 911 F.2d at 1061 (the *Restatement* explicitly limits an information supplier's liability to third parties the supplier "actually knows" will receive the information and will be influenced in their decisions regarding a business transaction). Comments to section 552 make clear that even parties that customarily rely on certain information are not entitled to bring a section 552 claim unless the information supplier knew at the time it supplied the information that it was for their benefit and guidance.[4] As the California Supreme Court notes:

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[4] *See, e.g.*, the following illustrations:

10. A, an independent public accountant, is retained by B Company to conduct an annual audit of the customary scope for the corporation and to furnish his opinion on the corporation's financial statements. A is not informed of any intended use of the financial statements; but A knows that the financial statements, accompanied by an auditor's opinion, are customarily used in a wide variety of financial transactions by the corporation and that they may be relied upon by lenders, investors, shareholders, creditors, purchasers and the like, in numerous possible kinds of transactions. In fact B Company uses the financial statements and accompanying auditor's opinion to obtain a loan from X Bank. Because of A's negligence, he issues an unqualifiedly favorable opinion upon a balance sheet that materially misstates the financial position of B Company, and through reliance upon it X Bank suffers pecuniary loss. A is not liable to X Bank.

> [b]y confining what might otherwise be unlimited liability to those persons whom the engagement is designed to benefit, the Restatement rule requires that the supplier of information receive notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.

Bily, 834 P.2d at 769. Thus, in this context, we reject any implication that classification societies can be liable for negligent misrepresentation to parties, including without limitation seamen, longshoremen, passengers, cargo owners, and charterers that may rely upon a survey or class certificate, absent actual knowledge by the classification society that the certificate or survey report was being provided for the guidance and benefit of the party.

We conclude that Otto Candies is eligible to bring a negligent misrepresentation claim against NKK under the facts of this case because NKK actually knew at the time it reclassified the SPEEDER that the results of the classification

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> 12. In 1934, A Company, a firm of surveyors, contracts with B to make a survey and description of B's land. A Company is not informed of any intended use of the survey report but knows that survey reports are customarily used in a wide variety of real estate transactions and that it may be relied upon by purchasers, mortgagees, investors and others. The survey is negligently made and misstates the boundaries and extent of the land. In 1958 C, relying upon the report that B exhibits to him, purchases the land from B, and in consequence suffers pecuniary loss. A Company is not liable to C.

Restatement (Second) of Torts § 552 cmt. h, illus. 10, 12 (1977).

survey were to be conveyed to Otto Candies for the purpose of influencing its decision to purchase the SPEEDER. The remaining issues are whether the district court clearly erred in finding that NKK supplied false information to Otto Candies, that NKK failed to exercise reasonable care in gathering the information, that Otto Candies reasonably relied on the information, and that as a result of relying on the false information Otto Candies suffered pecuniary loss.

The district court found that NKK provided false information by issuing a class certificate free of recommendations in light of the various defects in the hull and machinery of the SPEEDER. NKK argues that the district court clearly erred in making this finding. We disagree.

Before a classification society issues a class certificate free of recommendations, it must be satisfied that the certified vessel complies with the society's rules and standards for ships of the relevant class. *See* Machale A. Miller, *Liability of Classification Societies from the Perspective of United States Law*, 22 Tul. Mar. L.J. 75, 77-81 (1997) (describing the class certification process). By issuing a class certificate free of recommendations, a classification society necessarily represents that the vessel so complies. *Cf. Great Am. Ins. Co. v. Bureau Veritas,* 338 F. Supp. 999, 1011-12 (S.D.N.Y. 1972) (when a society undertakes to classify a vessel it accepts a duty to survey and classify the vessel in accordance with society's own rules and standards), *aff'd*, 478 F.2d 235 (2d Cir. 1973). The certificate or survey in no way guarantees a vessel's seaworthiness, however, but extends only as far as the nature of the survey performed.

In this case, expert witnesses presented by both parties testified that the various items of damage and deterioration found by Stroubakis were relevant to and would affect the

SPEEDER's NKK classification. Ian Smith, NKK's expert witness, testified that the deficiencies of the type noted by Stroubakis should be noted by a surveyor performing a class survey. Furthermore, Ben Haveman, Otto Candies's expert witness, testified that the various deficiencies should have been addressed during NKK's certification process. Based on their testimony, the fact finder could reasonably infer that NKK's certification of the SPEEDER free of recommendations constituted false information because the SPEEDER did not comply with the society's rules and standards for classification at the time of the survey. Thus, the district court did not clearly err in finding that NKK provided false information.[5]

Haveman's testimony also sufficiently supports the district court's finding that NKK failed to exercise reasonable care in gathering the information relevant to the SPEEDER's certification. Haveman testified that the NKK surveyor should have found the various deficiencies in the SPEEDER's hull and machinery - many of them open and obvious - that Stroubakis discovered during his inspection.

NKK also challenges the district court's finding that Otto Candies actually and justifiably relied on the false information. We hold that the district court did not err in making this finding. Otto Candies, Jr., the chief executive officer of Otto Candies, L.L.C., testified that but for NKK's certification of the SPEEDER as a coastal passenger vessel free of recommendations, the company would not have purchased the SPEEDER. Furthermore, the district court did not err in finding Otto Candies's reliance on the certificate to

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[5] NKK is not being held liable, as it contends, for the vessel's failure to satisfy ABS standards after being shipped to the U.S.

be reasonable. NKK is one of the world's largest classification societies. In addition, NKK is a member of the International Association of Classification Societies ("IACS") which prescribes certain minimum standards for classification societies. Only eleven of the world's fifty classification societies qualify for membership in IACS. Machale A. Miller, *supra*, 22 Tul. Mar. L.J. 75, 77 n.6 (1997).

Finally, NKK argues that the district court erred in finding that Otto Candies suffered pecuniary loss as a result of the false information. The district court awarded Otto Candies as damages the cost to repair the deficiencies noted by Stroubakis. Whether this is a proper measure of damages is uncertain, but because NKK did not brief its reasons for contesting the damage award, the contention is waived.

CONCLUSION

Based on the foregoing discussion, we agree with the district court that Otto Candies could properly bring a negligent misrepresentation claim against NKK and that the district court did not clearly err in finding that NKK was liable for negligent misrepresentation. The judgment is **AFFIRMED.**

APPENDIX C

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

Civil Action No. 01-1933 Section "M"

[Filed August 8, 2002]

OTTO CANDIES, LLC,)
)
VERSUS)
)
NIPPON KAIJA KYOKAI CORPORATION,)
)

JUDGMENT

Considering the court's Order and Reasons dated July 31, 2002, filed herein,

IT IS ORDERED, ADJUDGED AND DECREED that there be judgment in favor of plaintiff, Otto Candies, LLC, and against defendant, Nippon Kaija Kyokai Corporation, in the amount of $328,096.43, with interest to run from date of judgment.

New Orleans, Louisiana, this 8th day of AUGUST, 2002.

/s/
UNITED STATES DISTRICT JUDGE

APPENDIX D

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

Civil Action No. 01-1933 Section M

[Filed August 5, 2002]

OTTO CANDIES, LLC	)
	)
VERSUS	)
	)
NIPPON KAIJA KYOKAI CORPORATION	)
	)

ORDER AND REASONS

This matter came for trial without a jury on March 18-19, 2002. After consideration of the evidence presented at the trial, the post-trial memoranda and the applicable law, pursuant to Federal Rule of Civil Procedure 52(a), the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

Plaintiff, Otto Candies, L.L.C, is a Louisiana limited liability corporation with its principal place of business in Des Allemands, Louisiana. Defendant, Nippon Kaiji Kyokai (NKK) is a Japanese Classification Society with its principal place of business in Tokyo, Japan. Plaintiff's claim arises out of a classification survey conducted by NKK on M/V

SPEEDER, a vessel purchased by plaintiff through a ship broker from Diamond Ferry, Co., Ltd., a Japanese company.[1]

Diamond Ferry operated the vessel as a coastal passenger ferry in Japan from 1995 until 1998, when Diamond Ferry took M/V SPEEDER out of service and placed her on the market for sale. Although NKK issued a certificate of class for the newly constructed M/V SPEEDER in 1995, during the time M/V SPEEDER was laid up, she did not undergo any periodic NKK inspections or surveys and her NKK class certification lapsed.

Plaintiff learned of the vessel from a ship broker, James Aikenhead. Mr. Otto Candies, Jr., chairman and CEO of Otto Candies, L.L.C., traveled to Japan in November, 1999 and conducted a short sea trial and personal inspection of the vessel. Mr. Candies testified that he traveled to Japan specifically to visit the vessel in dry dock. He testified that when he arrived, the vessel was in the water, the engines were running, and it was almost dark. He stated that they made a short sea trial and was aboard the vessel for approximately thirty minutes.

Correspondence between Mr. Aikenhead and Mr. Candies indicated that NKK was aware of the pending sale and was consulted regularly regarding classification issues, operation of the vessel in the Gulf of Mexico, and transfer of class from NKK to ABS. (See plaintiff's exhibits 19, 20, 22, 23, 26).

Otto Candies subsequently entered into a Memorandum of Agreement with Diamond Ferry to purchase M/V SPEEDER. The Agreement was signed on December 22, 1999 and

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[1] Diamond Ferry Co, Ltd. is not a party to this litigation.

included the condition that M/V SPEEDER's NKK Coastal Class be restored and current, and free from outstanding recommendations. The Memorandum of Agreement also gave Otto Candies the option of having M/V SPEEDER surveyed by the American Bureau of Shipping (ABS). Otto Candies, Jr. testified that he specifically asked for the NKK certification so that he could be assured that the vessel was in proper working condition.

A classification survey of safety equipment, hull and machinery for class re-entry was conducted by NKK and on January 5, 2000, NKK issued a Class Maintenance Certificate which noted that M/V SPEEDER was certified to be in class, as a coastal passenger ferry with no outstanding recommendations. Plaintiff paid the agreed upon price and the vessel was subsequently transported from Japan to Port Everglades, Florida aboard a heavy-lift ship. The vessel was then towed to Bender Shipyard in Mobile, Alabama by M/V CHRIS CANDIES. Upon arrival in Mobile, Otto Candies arranged to transfer the class from NKK to American Bureau of Shipping (ABS). An ABS surveyor inspected the vessel and prepared a report outlining the various deficiencies of a class nature that required repair before ABS would issue class certification.

Mr. Ian Smith, an expert in classification surveys, testified on behalf of the defendant. He testified that the purpose of a classification survey is to ensure that the vessel complies with the requirements of the classification society and that classification society surveyors are experts in assessing the condition of basic hull and machinery of ships. He further testified that when an item of the hull or machinery relates to class, it should be inspected by the surveyor and any deficiencies noted. Mr. Smith agreed that the items identified by the ABS surveyor as being of a class nature were indeed

matters relating to class and that if such deficiencies existed during a class survey, those deficiencies should have been noted by the surveyor and dealt with. He further testified that a transfer of class from one society to another should be fairly routine, like rubber stamping. He also testified that corrosion and wasting are deficiencies that take more than two or three months to develop.

The repairs that were identified as relating to class were made at Bender Shipyard at a cost to Otto Candies of $342,961.43.

CONCLUSIONS OF LAW

Although it is well established that a classification society is not the insurer of the seaworthiness of a vessel, few courts have had the occasion to address the efficacy of a third-party injury claim against a classification society based on a theory of negligent misrepresentation. In general, courts have relied upon Section 552 of the Restatement (Second) of Torts in recognizing a third party's claim for negligent misrepresentation. Section 552 requires the plaintiff to prove that:

> 1) the defendant, in the course of its profession, supplied false information for the plaintiff's guidance in a business transaction;
> 2) the defendant failed to exercise reasonable care in gathering the information;
> 3) the plaintiff relied upon the false information in a transaction that the defendant intended the information to influence; and
> 4) the plaintiff suffered pecuniary loss.

Coastal (Bermuda) Ltd. v. E.W. Sabolt & Co., 826 F.2d 424, 428-429 (5th Cir. 1987).[2]

Defendant first contends that it owed no duty to Otto Candies because it had no contract with Otto Candies. However, privity of contract is not necessary to prove a negligent misrepresentation claim. Sundance Cruises Corp. v. American Bureau of Shipping, 7 F.3d 1077 (2d Cir. 1993). Further, any claim by defendant that it did not provide the information for plaintiff's guidance or owe any duty to plaintiff is without merit. NKK states in Chapter 1 of its Conditions of Service for Classification of Ships and Registration of Installations that:

> 1. Classification of ships is to be regarded as the development and worldwide implementation of published Rules and Regulations of the Society which will provide for:
>
> (1) the structural strength of and the watertight integrity of all essential parts of the hull and its appendages,

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[2] In Cargill, Inc. v. Bureau Veritas, the court recognized the cargo owners right to claim negligent misrepresentation, but granted summary judgment in favor of the classification society on the basis that plaintiff failed to establish "actual and reasonable reliance" upon the certificate issued by the classification society. Cargill, Inc. v. Bureau Veritas, 902 F.Supp. 49, 52-53 (S.D.N.Y. 1995). In Coastal (Bermuda) Ltd. v. E.W. Sabolt & Co., 826 F.2d 424,428-429 (5th Cir. 1987), the Fifth Circuit held that a purchaser of fuel oil had a negligent misrepresentation claim against an independent surveyor who analyzed the fuel for the benefit of the owner, but was ultimately unable to prove negligence. In Somarelf v. American Bureau of Shipping, 720 F. Supp 441 (E.D.La. 1989), the Court allowed a negligent misrepresentation claim by a third party agent for the vessel owner against a classification society.

> (2) the safety and reliability of the propulsion and steering systems, and those other features and auxiliary systems which have been built into the ship in order to establish and maintain basic conditions on board thereby enabling the ship to operate in its intended service.

It is axiomatic that the purpose of the classification society is to provide assurance that the vessel is fit to operate in its intended service. This duty extends not only to the shipowner but also to third parties who rely upon this information. "Indeed, the very purpose of classification societies is to facilitate shipowners' dealings with third parties and to protect third parties who deal with and/or come in contact with their ships." See Liability of Classification Societies, 22 Tul. Mar. L.J. 75, 105-106 (1987).

The foregoing notwithstanding, the correspondence between plaintiff and the ship broker confirms that NKK was aware of the pending sale, transfer of class from NKK to ABS, and operation of the vessel in the Gulf of Mexico sufficient to establish that NKK provided the information for plaintiff's guidance.

Defendant next contends that plaintiff cannot prove its claim of negligent misrepresentation because there is no evidence of reliance by Otto Candies on any representations by NKK or on class certificates issued by NKK. Defendant contends that without evidence of a communication of specific information to Candies by NKK, and evidence that Candies relied upon that information in purchasing the vessel, plaintiff has not proven its claim. Defendant further maintains that Otto Candies agreed to purchase the vessel prior to the issuance of the certificate of classification and thus, there is no evidence of reliance. Defendant points out that the

agreement to purchase was signed on December 22, 1999 and the NKK survey was conducted on December 26, 1999.

The testimony of Otto Candies, Jr. indicates that restoration of class certification was a condition of the sale. Mr. Candies stated: "We needed to have that assurance that we had a clean certificate without any recommendations for our operations. NKK was the original society that furnished the first certificates. We thought they were the appropriate society to do it again." Trial transcript, p. 17-18. The certificate of classification was issued and the plaintiff proceeded with accepting delivery of the vessel. This is sufficient evidence that plaintiff relied upon NKK to survey the vessel in accordance with the standards of the society and identify any deficiencies that were of a class nature.

Defendant finally contends that evidence that M/V SPEEDER did not meet the ABS requirements is not evidence that M/V SPEEDER did not meet the NKK requirements. This assertion is without merit. The evidence has established that the deficiencies identified by the ABS surveyor, were as defendant's expert, Mr. Smith, agreed, "of a class nature" and that if such deficiencies existed during a class survey, those deficiencies should have been noted by the surveyor. Mr. Smith agreed that the deficiencies were of a nature that would take more than two months to develop and would have existed at the time of the NKK survey.

The Court finds that plaintiff has established by a preponderance of the evidence each element of a negligent misrepresentation claim. Defendant, Nippon Kyokai Corporation breached its duty to survey and classify M/V SPEEDER in accordance with its own rules and standards and plaintiff relied to its detriment on the classification survey. NKK owes a duty of due care in detection of defects on the

ships it surveys. This duty extends to third parties, such as Otto Candies, LLC, who actually and reasonably rely upon the certification.

Plaintiff's proof of damages with respect to the cost to repair the items that related to class was basically uncontested by the defendant. The court finds that plaintiff has established repair costs in the amount of $328,096.43. The Court finds that the expenses associated with the port engineer have not been proven to a reasonable certainty and are too far attenuated from the overall claim in this case to be recoverable.

With respect to plaintiff's loss of use claim, an injured party may recover damages for lost income only to the extent that those damages can be proven with reasonable certainty. Bolivar County Gravel Co. v. Thomas Marine Co., 585 F.2d 1306, 1308 n. 2 (5th Cir.1978). Here, plaintiff has not met that burden. Accordingly, the Court enters judgment in favor of plaintiff, Otto Candies, LLC, and against defendant, Nippon Kaija Kyokai Corporation, in the amount of $328,096.43.

New Orleans, Louisiana, this 31st day of July, 2002.

/s/_____

Peter Beer
United States District Judge